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JANUARY 19, 2021 | PUBLICATION

Client Alert: Families First Leave, Payroll Tax, and Employee Benefits Provisions in the Consolidated Appropriations Act

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The Consolidated Appropriations Act, 2021 (the "Act"), passed by Congress on December 21, 2020 and signed by the President six days later, is 5,593 pages long. While they didn't garner a lot of attention in the mainstream press, there are several important employment, payroll tax, and employee benefits provisions contained in the legislation. These provisions either extend or replicate special rules that were created in the Families First Coronavirus Response Act (the "Families First Act") and the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") that were both passed in 2020. This alert will discuss some of those provisions and how they can impact employers as we move into 2021.

Extension of Tax Credits for Paid Leave

The Families First Act created a requirement for employers with 500 or less employees to provide up to 80 hours of emergency paid sick leave, and up to 12 weeks of partially paid emergency Family and Medical Leave Act (FMLA) leave, to employees who are unable to work due to COVID-19-related reasons. The leave is funded through a tax credit that the employer can take against its liability for employment taxes. The calculation of those credits, including the limitations that apply to them, are described in our prior alert outlining the Families First Act. The mandatory leave and the related tax credits were set to expire on December 31, 2020.

The Act did not extend the requirement that employers offer emergency sick leave or emergency FMLA. However, the Act does extend the tax credit for paying leave through March 31, 2021. Therefore, between January 1 and March 31, 2021, employers have the option to pay leave to employees under a situation in which the leave would have been required under the Families First Act, and the employer will receive a tax credit for the amount they pay in leave, even though the leave is no longer mandatory.

The extension of the tax credit provision does not create a new entitlement of paid time off for any employee who already has used 80 hours of emergency paid sick leave – it merely allows the employee to carry over any unused emergency sick leave from 2020 into 2021. The Act does not allow an employer to claim a second tax credit for providing additional time off to an employee who already took emergency sick leave for which the employer took a tax credit.

As to emergency FMLA, the availability of leave is a little more complicated. It appears whether or not an employee will have a new 12 weeks of leave available in 2021 will be dictated by the 12-month period identified by the employer in its FMLA policy. Emergency FMLA was not a new type of leave, but instead a new basis to use available FMLA leave. Under the FMLA, employers select the 12-month period (calendar year, rolling forward, etc.) in which an employee is entitled to up to 12 weeks of leave. If the employer's selected 12-month period results in the employee having a new bucket of FMLA leave available in 2021, then the employee can again use the available leave for emergency FMLA. For example, employers who use the calendar year as their 12-month period, as of January 1, 2021 their employees have a new 12 weeks of FMLA leave that is available for use, including for emergency FMLA. As with the extension of emergency sick leave, the extension of the availability of the credit does not allow an employer to claim a second tax credit for an employee for whom the maximum credit for emergency FMLA was claimed in 2020.

As indicated above, as of January 1, 2021, it is now an employer's choice whether to continue to offer emergency sick leave, emergency FMLA, both, or none. To avoid claims of discrimination or retaliation, it is recommended that employers implement their decision on a company-wide or at least departmental basis. Employers need to decide what, if any, Families First leave they will offer in 2021, notify their employees of the decision, and update policies as necessary.

The Families First Act also included a similar tax credit that self-employed individuals can take if they would have been able to take paid leave, if they were employed instead of self-employed, for the reasons specified in the Families First Act. This tax credit has also been extended until March 31, 2021.

The Act doesn't provide any additional specifics about claiming these credits, so the procedures previously released by the Internal Revenue Service (IRS) and described in our alert dated April 3, 2020, should continue to apply to employers looking to claim the tax credit for leave taken in 2021. If you need assistance properly documenting Families First leave or have any questions on the FFCRA, please contact us.

Expansion of Employee Retention Tax Credits

To encourage employers to retain their employees in the pandemic, the CARES Act created an employee retention tax credit. The credit under the CARES Act was available to employers whose business was closed due to government stay-at-home orders or whose business suffered a significant decline in gross receipts compared to the previous year, measured on a quarterly basis. The credit was equal to 50 percent of the "eligible wages" that were paid to employees, with a maximum of $10,000 in eligible wages per employee. The calculation of eligible wages can also include an allocation of health insurance expenses for the employee. However, the employee retention credit wasn't available to an employer who took a Paycheck Protection Program (PPP) loan, since the PPP funds are forgivable and intended to fund payroll expenses for employers.

The Act expands employee retention credits in a few ways:

- It makes the credit available to employers who have received a PPP loan. This change is retroactive to the start of the employee retention credits and only expands eligibility for the credit, it does not otherwise change how the retention credit is calculated for wages paid in 2020. The credit can only be

taken to the extent of wages that weren't used for the forgiveness of the PPP loan.

- The Act also specifically provides that any group health plan expenses that are not included in an employee's income can be included in qualified wages that are used to calculate the employee's qualified wages.
- It extends the employee retention credits until June 30, 2021, rather than the original December 31, 2020 ending date.
- It increases the maximum available credit for 2021 wages to 70 percent of eligible wages, as opposed to the 50 percent of eligible wages paid in 2020 (but these changes do not affect the 50 percent maximum credit available for 2020 eligible wages). There is also an increase to the amount of eligible wages from a per-employee maximum of $10,000 in total wages in all of 2020 to a maximum of $10,000 for each quarter in 2021. Therefore, with the credit available for the first two quarters of 2021, it is possible to claim a maximum credit of $14,000 per employee (70 percent of up to $10,000 of wages per quarter times two quarters).
- Finally, under the original version of the credit, any employer who had more than 100 employees could only claim the credit with respect to employees who were paid for, but not providing services to the employer due to COVID-19 circumstances (employers with 100 or less employees can claim the credit for payment of wages to any employee). In the updated version of the credit, the 100 employee threshold has been increased to 500 employees, so the credit should be available to more employers.

Additional Deferral of Employee Federal Insurance Contributions Act (FICA) Taxes

In Notice 2020-65, the IRS published guidance that permits employers to defer the payment of the employee share of Social Security taxes on wages paid from September 1, 2020 until December 31, 2020. These taxes aren't forgiven, but payment of the taxes could be deferred. Under the Notice, those taxes were required to be paid to the IRS from January 1, 2021 until April 30, 2021. In the Act, Congress directs the IRS to extend the payment date for these taxes until December 31, 2021. The deferral was available to the extent that an employee's Social Security wages do not exceed $4,000 for a biweekly pay period.

As was the case before the extension, any employer who decided to participate in this deferral still must determine how to collect and pay the taxes that were deferred under this program, since these taxes are the responsibility of employees. Employers can now withhold additional amounts from employees throughout 2021 in order to recoup those taxes, or simply pay the taxes on behalf of the employees part without withholding them. In the second scenario, however, this creates additional taxable income to the employee.

Distributions from Money Purchase Plans

The CARES Act created a Coronavirus distribution from qualified retirement plans of up to $100,000 that can be repaid to the plan and is exempt from the 10 percent excise tax that applies to early distributions from a qualified plan. It was unclear from the CARES Act whether these distributions could be made from money purchase plans, which are defined contribution plans in which employer contributions are mandatory and distributions are subject to qualified joint and survivor rules. The Act expressly provides that Coronavirus distributions may be made from money purchase plans, so the special tax rules that apply to Coronavirus distributions will also apply to them.

Special Rule for Partial Plan Terminations

A qualified retirement plan can have a "partial termination" if a significant number of its participants incur an involuntary termination of employment in a short period of time. Under longstanding IRS guidance, a partial termination of a plan is presumed if 20 percent or more of its active participants have an employer-initiated termination of employment during a 12-month period. However, this is not a clearly defined rule

and the IRS can argue that a partial termination took place if the turnover rate is less than 20 percent. The consequence of a partial termination is that all participants who are affected by the partial termination must be 100 percent vested in their accrued benefit, to the extent funded.

The Act creates a special rule, which provides that a partial termination will not occur for any plan year that includes the period from March 13, 2020 to March 31, 2021, if the number of active participants covered by the plan on March 31, 2021 is at least 80 percent of the number of active participants covered by the plan as of March 13, 2020. This could mean that, if an employer laid off more than 20 percent of its workforce around the beginning of the pandemic, it could avoid a partial termination if it hires enough of its workforce back (and makes sure that they are eligible to participate in the plan) before March 31, 2021. The Act doesn't require that the same employees be hired back, it is strictly a comparison of the number of active employees on March 13, 2020 and March 31, 2021.

Qualified Disaster Distributions and Loans

The Act creates temporary distribution and loan opportunities to help those affected in 2020 by natural disasters such as wildfires and hurricanes. Consistent with the CARES Act distribution and loan opportunities from qualified plans, these opportunities include:

- Distributions of up to $100,000 that can be taken from a qualified plan that are not subject to the 10 percent excise tax that normally applies to early distributions, can be repaid in the three-year period after the distribution, and if the distribution was not repaid to the plan, can have taxable income spread out over three tax years instead of all in the year of the distribution.
- Loans with increased limits from the normal rules of 50 percent of the vested balance (up to $50,000) to 100 percent of the vested balance (up to $100,000).
- The ability to delay making payment on certain plan loans.

It's important to note that while COVID-19 has been declared as a disaster, the expanded distribution and loan rules do not apply to areas for which COVID-19 is the only major disaster that has been declared.

Changes to Flexible Spending Account Rules

Employees who made contributions to a health flexible spending account (FSA) or a dependent care flexible spending arrangement may not have used all of those contributions in 2020. To give employees more flexibility, the Act gives employers several alternatives to make those funds available to a greater extent than they normally would be under the normal "use it or lose it" rules that apply to these plans. These changes are optional, and employers will need to adopt amendments to the applicable plans in order to take advantage of them.

First, a health FSA or dependent care FSA may be amended to allow participants to carry over any unused amounts from 2020 into 2021. These plans can also be amended to allow unused amounts to be carried over from 2021 into 2022. In both cases, the carryover is unlimited – under existing rules, a health FSA (but not a dependent care FSA) can allow for a carryover of up to $500 from one year into the next.

Second, a health FSA or dependent care FSA which has a grace period in which unused amounts can be spent for a 2½ month period into the following year can be amended to extend the grace period to 12 months. This applies to any plan years ending in 2020 or 2021. An FSA can have a grace period instead of a carryover, but a plan cannot have both.

Another change that is available under a health FSA is that it may be amended to allow an employee who

loses eligibility to participate in the plan (usually due to a termination of employment) during 2020 or 2021 to continue to receive reimbursements through the remainder of the plan year in which the employee lost eligibility, including the plan's grace period (which now may be up to 12 months). Finally, for 2021 plan years, a health FSA or dependent care FSA can allow participants to change their contribution elections on a prospective basis, even without a qualifying change in status.

Any of these plan changes will require an amendment to be signed by the employer. For calendar year plans, the amendment deadline for changes applying to the 2020 plan year is December 31, 2021, and the deadline for changes applying to the 2021 plan year is December 31, 2022.

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